IN THE HIGH COURT OF HIMACHAL PRADESH,
SHIMLA.

Civil Suit No. 26 of 2002.

Judgment reserved on 12.10.2007.

Date of Decision: 1st January,2008.

The Himachal Pradesh State Industrial Development Corporation Limited

……Plaintiff.

Versus.

M/s Sunrise Malt (P) Ltd. and others …. Defendants

Coram

The Hon'ble Mr. Justice Dev Darshan Sud,Judge.

Whether approved for reporting?[1]

For the Petitioner: Mr. Ajay Kumar, Advocate.

For the Respondents: Mr. K.D. Sood, Advocate, for defendant Nos. 1 to 5.

Dev Darshan Sud, Judge.

The plaintiff has instituted this suit for recovery of a sum of Rs. 55,55,706.00 along with cost and interest @ 20% per annum from the date of suit till its realization with half yearly rests.

The allegations in the plaint are that two term loans of Rs. 17 lacs and Rs. 11.54 lacs (totaling Rs. 28.54 lacs) were sanctioned in favour of defendant No. 1, which is a private limited Company, incorporated under the Companies Act, 1956, for the purposes of purchase of land, construction of factory building and purchase of

[1] Whether Reporters of Local Papers may be allowed to see the judgment?

machinery etc. The plaintiff pleads that for securing the loans, defendant Nos. 2 to 4, who are its Directors, executed promissory notes, loan agreements and hypothecation deed(s) for land, building plant and machinery etc. The plaintiff avers that in addition to this security, an equitable mortgage was created by defendant No. 1 by deposit of title deed(s) of the properties of defendant No. 1. Defendant Nos. 2 to 5 executed guarantee deed(s) on 26.5.1992, 29.5.1992 and 29.10.1992 guaranteeing the repayment of the loans.

According to the plaintiff, defendants failed to comply with the terms and conditions of the loan agreements despite the fact that on 26.10.1995 defendant No. 1 had applied for permission for change in management which was allowed by the plaintiff on 23.5.1996 on certain terms and conditions. One of the concession sought was permission for the reschedulement of the repayment of the loan amount. The defendants failed to execute revised loan documents within the stipulated period as asked for and conveyed to them by the plaintiff.

The plaintiff alleges that proforma defendant No. 6, (H.P. State Financial Corporation) took over the assets of defendant No. 1 on 16.5.1997 exercising its statutory right under Section 29 of the State Financial Corporations Act 1951. These assets were sold for a sum of Rs. 24 lacs and Rs. 7,49,273/- was paid to the plaintiff after proforma defendant No. 6 had adjusted a part of the sale consideration for discharge of the loans of defendant No. 1. The plaintiff claims a sum of Rs.1,28,83,574/- (one crore twenty eight lacs eighty three thousand five hundred and seventy four only) and

pleads that a sum of Rs. 73, 27,868/- is not being claimed by it and has been waived.

The suit of the plaintiff has been resisted by the defendants on a number of grounds. The primary defence is that defendant Nos. 3, 4 and 5 are absolved of their liability as the management of defendant No. 1 has been transferred to Vijay Kumar Kaplesh, John Nycil Mendez, Suresh Chauhan and Raj Kumar Sharma with the consent of the plaintiff on the specific understanding that the liability of the defendants would be discharged. The defendants plead novation of contract as discharging their liability. According to them, the management changed on 24.11.1995 when, according to defendant No. 3 a sum of 16 lacs was paid to proforma defendant No. 6 who also got fresh documents executed from them. The defendants pleaded that there is novation of contract and that they are discharged from their liability. Another plea taken by the defendants is that when the Industrial Unit of defendant No. 1 was taken over by proforma defendant No. 6 and advertised for sale, defendant Nos. 1 and 2 gave their assent for the finalization of the sale subject to the condition that the entire loan outstanding both with the plaintiff and proforma defendant would be settled and cleared for the amount so received. A number of other objections have been taken but which will be considered under various issues where they arise for determination.

The following issues were framed by this court on 29.5.2003:-

1. Whether the plaintiff is duly incorporated company under the Companies Act and Sh. Pawan Kumar Bali

is authorized to file the present suit?

….. OPP

2. Whether the plaintiff is entitled to the suit amount and interest, if so, of what amount and rate?

…. OPP

3. Whether the suit of the plaintiff is within the period of limitation? …..OPP

4. Whether the suit is bad for mis-joinder and non-joinder of necessary parties, as alleged. If so, its effect?

… OPD

5. Whether there was novation of contract, as a result of which, defendants 3 to 5 stood absolved their liabilities? …. OPD.

6. Whether the defendants have discharged the entire loan liability by paying Rs. 24 lacs by Sh. Dinesh Kumar, as alleged? … OPD

7. Whether the plaintiff has not come to the court with clean hands. If so, its effect?

…OPD

8. Whether the plaintiff is estopped from filing the suit on account of its own acts, deeds, conduct and acquiescence, as alleged? …..OPD.

9. Whether the defendants suffered loss on account of alleged acts of negligence on the part of the plaintiff. If so, its extent and defect?

….. OPD

10. Whether the plaintiff has unauthorizedly debited, the account of the defendants to several charges including expenses and interest. If so, its effect?

…..OPD

11. Relief.

ISSUE NO. 1.

Whether the plaintiff is duly incorporated company under the Companies Act and Sh. Pawan Kumar Bali is authorized to file the present suit?

….. OPP

There is no evidence on the record to show that the suit has not been instituted by a duly authorized person. PW-2 Pawan Kumar Bali was the Manager Project (Legal) of the plaintiff who proved Ext. PW-2/A which is the certificate of incorporation of the plaintiff and Ext. PW-2/B, a copy of Resolution No. 12 authorizing the Manager to file suits on behalf of the plaintiff in any court of law. He also proved Ext. PW-2/B/1 and Ext. PW-2/B/2 and Ext. PW-2/C being annexures to the Resolution of the Board of Directors and the authority granted to this witness to institute the suit. There is nothing in the cross-examination of this witness to show that he has no authority to file the suit on behalf of the plaintiff. This issue is therefore, decided in favour of the plaintiff and against the defendants.

ISSUE NO. 3.

Whether the suit of the plaintiff is within the period of limitation? …..OPP

The Hon'ble Supreme Court in **H.P. Financial Corporation** *vs*. **Smt. Pawna and others** **Civil Appeal No. 1971 of 1998** along with other Special Leave Petitions decided on 18.12.2003, held that the cause of action to claim the balance loan amount would arise to the Corporation after the assets of Industrial concern/party have been

disposed of pursuant to proceedings under Section 29 of the State Financial Corporation Act. There is no dispute before me that the Industrial assets of defendant No. 1 was taken over on 23.5.1997 and that the Industrial Unit was auctioned by proforma defendant No. 6 on 21st July, 2001 when it was purchased by one Mr. Dinesh Kumar for a sum of Rs. 24 lacs. The suit having been instituted on 9.4.2002 is within time. This issue is, therefore, decided against the defendants and in favour of the plaintiff.

ISSUE NO. 5.

Whether there was novation of contract, as a result of which, defendants 3 to 5 stood absolved their liabilities?

.... OPD.

This is the primary defence which has been taken by the defendants. DW-3 Shri Amar Nath has appeared as a witness and stated that agreement Ext. DW-3/A was executed between him and the new Management. After this, Shri Raj Kumar used to deal with the plaintiff. All previous Directors of the Company, according to him, were exonerated of their liability and it was only the "New Management" which was dealing with the plaintiff and the world at large. As such the defendants are not liable to pay any amount. He deposes that he had consented for the sale of the unit to his son Dinesh Kumar for a sum of Rs. 24 lacs and vide Ext. DW-3/B he had conveyed his consent. The confirmation of the sale was subject to the condition that the entire loan amount was liquidated. He admits that proforma defendant No. 6 had filed a suit for recovery against him and the other Directors including the "New Management" before the Debt Recovery Tribunal at Chandigarh.

DW-4 Shri Shanti Swarup Kaplish testified that the Industrial Unit of defendant No. 1 was taken over by Shri Vijay Kumar Kaplish, John Nycil Mendez, Suresh Chand Chauhan and Raj Kumar Sharma all of whom are Non Resident Indians and they use to deal with the Financial Corporation directly. He states that he resigned from the Company on 24.11.1995 and has proved on record Ext. DW-4/A which is his resignation letter. He further testifies that he wrote to the plaintiff that his Guarantee Deed(s) may be released. This was contained in letters addressed by him Ext. DW-4/B, Ext. DW-4/D and Ext. DW-4/F.

DW-2 is the Senior Assistant (Legal) of proforma defendant No. 6. He testifies that Rs. 59 lacs were advanced by the H.P. Financial Corporation proforma defendant No. 6 to the plaintiff vide agreement Ext. DW-2/A. Revised schedule of payment between the loanees and proforma defendant No. 6 is Ext. DW-2/C. He states that "New Management" of the Company executed Deed(s) of Guarantee Ext. DW-2/4. Other loan documents being Ext. DW-2/A and Ext. DW-2/C were also proved by him on the record. He admits that a suit has been filed by defendant No. 6 against other defendants in the Debt Recovery Tribunal, Chandigarh.

Section 62 of the Indian Contract Act, 1872 deals with the novation of contracts. It provides:

> **"62. Effect of novation, rescission, and alteration of contract.-** If the parties to a contract agree to substitute a new contract for it, or to rescind or alter it, the original contract need not be performed."

The provision clearly recognizes the principle that a new contract should rescind, alter or extinguishes the original contract and this is to be done by a specific agreement amongst the parties to the original contract. The evidence on the record does not show or indicate that such rescission has in fact been made or that there has been an agreement *inter se* between the parties to the suit rescinding, altering and amending the original agreements in the nature of loan documents or guarantees deed(s) executed by the defendants. It is undisputed before me that permission to change the management was granted to the defendants by the plaintiff on certain terms and conditions which were required to be fulfilled by the defendants as conditions precedent for acceptance of charge/substitution of the liabilities and absolving the defendants of their liabilities. Ext. PW-2/V is a communication dated 26.10.1995 addressed by the Managing Director of defendant No. 1 to the Managing Director, H.P. State Financial Corporation stating therein that they have been able to identify S/Sh. Vijay Kumar Kaplesh J.P. Sharma and Raj Kumar Sharma who would take over the new management. Copy of this communication has been endorsed to the plaintiff. It refers to an earlier communication having been addressed to the plaintiff on the subject and than proceeds to state that these four persons named in the letter are willing to take over the company on the conditions:

> "1. That they shall pay an amount of Rs. 25.00 lacs immediately on down payment as token of interest for effecting the said change of management.
>
> 2. The balance outstanding amount of HPFC & HPSIDC Ltd. after adjustment of above Rs.

25.00 lacs shall be repaid within the existing schedule as conveyed while approving our earlier rehabilitation plan-cum- change of management proposal with minor adjustment on account of payment being made by us.

3. We shall be sending details of bio-data, assets and liabilities position and proposal of the new management alongwith payment of Rs. 25.00 lacs within a period of 15 days."

Vide Ext. PW-2/X, proforma defendant No. 6 has granted its approval conveying that at the meeting of the Executive Committee of the defendant held on 29.11.1995, the proposal has been approved promising certain incentives etc. Vide Ext. PW-2/Y, which is a communication dated 29.1.1996 addressed to the Managing Director of the plaintiff, the defendants ask for time to submit a detailed proposal including change of management along with complete bio data of the proposed Directors . Ext. PW-2/W is an important document which may be noticed in detail. It recites:-

"Managing Director,
M/s Sunrise Malt (P) Ltd.,
Plot No.. 11, Industrial Area,
BILASPUR (H.P)-174001.

Subject: Changement of management & Rehabilitation

Dear Sir,

This has reference to your proposal dated 29th January, 1996 for the rehabilitation of the Unit and change of management submitted to HPSIDC &HDFC. We are pleased to inform you that the proposal for change of management and rehabilitation of the Unit has been considered and approved on the following terms and conditions:-

1. S/Shri Vijay Kumar Kaplesh, John Nycil Mendez, Raj Kumar Sharma and Suresh Chand Chauhan shall be inducted as Directors replacing Smt. Manorma Devi and Shri Shanti Swaroop.

2. The new Directors shall guarantee and shall also executed the legal documents for securing the outstanding loan of the Corporation.

3. Funding of our due interest: The interest in default amounting to Rs. 12,21,000/-, after the waiver of penal interest charged upto 10.1.1996 amounting Rs. 92,000/- approximately (subject to audit) has been kept in a separate account and shall be repaid back along with interest & 16% p.a. with half yearly rests in the following manner:-

10.7.1996	3.06
10.1.1997	3.05
10.7.1997	3.05
10.1.1998	3.05.
Total:	Rs. 12.21 lacs.

4. Reschedulement of repayment of term loan: The repayment of term loan of Rs. 25.59 lacs is rescheduled, which shall be repayable as under:-

	(Rs. in lacs)
10.7.1998	2.84
10.1.1999	2.84
10.7.1999	2.84
10.1.2000	2.84
10.7.2000	2.84
10.1.2001	2.84
10.7.2001	2.84.
10.1.2002	2.84
10.7.2002	2.87
Total:	25.59 lacs

The above amount shall carry interest @ 19% p.a. and in case of default on timely payment, the

penal interest @ 4% shall be extra on the defaulted amount for the defaulted period.

You are requested to send us your acceptance and execute the revised loan documents within one month.

Thanking you,

Yours faithfully,
For HPSIDC Ltd.

Manager (R&M)

CC: Managing Director, HPFC, Shimla, for information.
CC: Manager (Project)."

This is followed by a telegram Ext. PW-2/Z stating that no acceptance has been conveyed by the defendants of the terms and conditions as conveyed vide Ext. PW-2/W. The telegram asks/requires the defendants to immediately send their acceptance and execute the documents by June, 23, failing which, concessions offered may be withdrawn. Defendants responded vide Ext. PW-2/B-B stating that time limit for complying with the conditions may be extended as their Directors are abroad and will be coming to India in the month of July. This is followed by another telegram Ext. Pw-2/AA acknowledging telegram dated 18th June asking the defendants to execute the documents asked for by June 30. Defendants were asked to send their response by 30th June, failing which, concession offered would be withdrawn. On 12th August, 1996, vide Ext. PW-2/CC another request is made by the defendants for extension of

time till November, 1996 for executing the documents and complying with the conditions imposed by the plaintiff. This is the entire evidence on the record. The documents and the evidence on the record do not establish any novation of contract. The acceptance of the proposal which was given by the plaintiff was subject to fulfillment of certain conditions as clearly contained and stipulated in Ext. PW-2/W which have not been complied with. There is no explanation on the record as to why such compliance was not made or that there was any impossibility or reason for non compliance performance of these conditions. There is no evidence that performance of these conditions was dispensed with by the plaintiff. The provisions of Section 62 have already been noticed above. In **Lata Construction and others** *vs*. **Dr. Rameshchanandra Ramniklal Shah and another** **AIR 2000 SC 380** it has been held:-

> "11. One of the essential requirements of 'Novation'; as contemplated by Section 62, is that there should be complete substitution of a new contract in place of the old. It is in that situation that the original contract need not be performed. Substitution of a new contract in place of the old contract which would have the effect of rescinding or completely altering the terms of the original contract, has to be by agreement between the parties. A substituted contract should be rescind or alter or extinguish the previous contract. But if the terms of the two contracts are inconsistent and they cannot stand together, the subsequent contract cannot be said to be in substitution of the earlier contract."

Learned counsel for the plaintiff referred to some other decisions which are being noticed but are not being considered in

detail as the law has been settled by the Hon'ble Supreme Court. He referred to the decision of the Nagpur High Court in **Ganpat** *vs.* **Mahadeo and others AIR 1925 Nagpur 26** holding that a fresh contract must be proved to be in existence which, in fact wipes out all the obligations under the old contract . To similar effect is the judgment of the Lahore High Court in **Guranditta Mal-Sant Ram and another** *vs* **Labhu Ram-Lachman Das AIR 1936 Lahore 476** reaffirming that there must be a clear and present substitution of another contract for the original and not a mere agreement to substitute one in future. At the cost of repetition it may be added that there is no fresh agreement(s) between the parties substituting, altering, amending or changing the original loan agreement(s) and guarantee deed(s). This issue is, therefore, decided against the defendants.

ISUE NO. 4.

Whether the suit is bad for mis-joinder and non-joinder of necessary parties, as alleged. If so, its effect?

... OPD

Learned counsel for the defendants has urged that the suit is bad for mis-joinder of parties and non-joinder of necessary parties. The contention raised is that the plaintiff having accepted the arrangement allowing a new set of Directors to take over the management, they were necessary parties and that defendants have been unnecessarily impleaded in the suit. The submission is that defendant Nos. 3, 4 and 5 have been absolved of their liability and the guarantee deed(s) executed by them are no longer enforceable. This submission of the defendants cannot be accepted. I have already held that there has been no substitution of the contract

between the parties. It has also not been proved by the defendants that they had complied with the conditions imposed by the plaintiff for accepting a new management who would take charge of the affairs of the Company- defendant No 1. In fact, the conditions imposed by the plaintiff vide Ext. PW-2/W calling upon them to have fresh documents executed, have not been complied with despite reminders vide Ext. PW-2/Z and Ext. PW-2/AA. In these circumstances, it cannot be said that so called Directors of the new management, contemplated in Ext. PW-2/W were necessary parties as they never executed any document(s) or guarantee deed(s) with the plaintiff.

Learned counsel for the defendants has placed emphasis on Ext. DW-3/A which is an agreement executed on 21st November, 1995 between defendant Shri Amar Nath Vatsayayen, Smt. Manorama Devi, Shri Shanti Swaroop Kaplesh on the one part and Shri Vijay Kumar Kaplesh, John Nycil Mendz, Shri Raj Kumar Sharma and Sh. Devinder Chauhan on the second part whereby the entire management, assets etc. have been handed over by these parties to the defendants. The plaintiff is not a signatory to this agreement. Similarly in Ext. DW-2/A, which is an agreement-cum-undertaking executed on 24-11-1995 by S/Sh. Vijay Kumar Kaplesh, R.K. Sharma, Suresh Chand Chauhan, and A.N. Vatsayan in favour of H.P. Financial Corporation, there is no acceptance by the plaintiff or anything to indicate that plaintiff was also a party or privy to this agreement. Similarly, the trust letter Ext.PW-2/B and

Ext. PW-2/C (the revised repayment schedule) have been executed by the defendants in favour of the H.P. Financial Corporation. These documents do not, in any manner alter the contract entered into by the defendants with the plaintiff. There is nothing on the record to indicate that the plaintiff had accepted/acquiesced in this arrangement entered into between the defendants and proforma defendant No. 6. The law which has been noticed on the point of novation is clear and unequivocal that new contract(s) is required to substitute the terms conditions and obligations of existing contract(s). Unilateral acts or any intention expressed by any party to enter in to an agreement in future or to substitute an agreement on certain conditions which, have not been proved to have satisfied on the record cannot constitute novation in any sense. There is nothing on the record to show or establish that plaintiff had, in any manner accepted the change in the management or agreed to grant any concession unilaterally to the defendants. Rather the change and the concessions were subject to fresh documentation. There being no fresh contract(s) on the record, the plea of novation as put forth by the defendants cannot be accepted. This issue is therefore, decided against the defendants and in favour of the plaintiff.

ISSUE NO 6.

Whether the defendants have discharged the entire loan liability by paying Rs. 24 lacs by Sh. Dinesh Kumar, as alleged? … OPD

There is no evidence on the record to show that the plaintiff at any point of time accepted the discharge of the entire liability of the

defendants on payment of Rs. 24 lacs having been paid to them. Learned counsel for the defendants has referred to Ext. DW-3/B which is a communication addressed to the Managing Director of proforma defendant No. 6 in which he has written that:-

"To

The Managing Director,
H.P. Financial Corporation,
Shimla -1.

Sub: Sale of assets of Sunrise Malt Pvt. Ltd. Bilaspur,

Respected Madam,

This has reference to your office letter No. 4338 dated 24.7.2001 vide which you have intimated that the Corporation has received highest offer of Rs. 24.00 lacs for the purchase of assets of our unit. You have advised to produce any better buyer than the offer of Rs. 24.00 lacs received by the Corporation.

In this connection I would like to inform you that Dinesh Kumar is my son. I had prevailed upon him to make offer for the purchase of assets of above concern. Other directors of the unit have left the country and settled abroad and they have no interest to start the unit. I hereby give my consent for the sale of assets of the unit for total sale consideration of Rs. 24.00 lacs given by my son subject to the condition that the entire loan outstanding of both the Corporations i.e. HPFC & HPSIDC is settled and clearance certificate is issued in favour of the company.

Thanking you,

Yours faithfully,

(Amar Nath Vatsyan)
Director,

Sunrise Malt Pvt. Ltd.
Dated:27.7.2001 Bilaspur (HP).”

This communication is addressed by the defendants to proforma defendant No. 6. A substitution of contract between these two parties or condition imposed by the defendants that proforma defendant No. 6 should or should not act in a particular manner cannot be read as a condition imposed upon the plaintiff and to absolve the defendants of their liability. The defendants had executed fresh documents with proforma defendant No. 6 but not with the plaintiff. In these circumstances, I find that there is no substance in the submission which has been made by the learned counsel for the defendants. This issue is accordingly decided against the defendants.

ISSUE NOS:

7. Whether the plaintiff has not come to the court with clean hands. If so, its effect?
...OPD

8. Whether the plaintiff is estopped from filing the suit on account of its own acts, deeds, conduct and acquiescence, as alleged? *.....OPD.*

9. Whether the defendants suffered loss on account of alleged acts of negligence on the part of the plaintiff. If so, its extent and defect?
..... OPD

These issues being interconnected, are taken up for decision together. There is no evidence on these issues to show that the plaintiff has not approached this court with clean hands and that the plaintiff is barred from claiming the suit amount. There is also no evidence to support the contention of the defendants that the plaintiff is barred by the principle of estoppel from instituting and

maintaining the present suit or that defendants have suffered huge losses on account of acts of negligence committed by the plaintiff. There is no evidence that the defendants have suffered any loss on account of alleged act of the plaintiff or the plaintiff has committed an act providing the defendants with a cause of action for recovery of any amount. The defendants' own conduct shows that they never accepted any of the conditions asked for by the plaintiff which would absolve them of their liability. These pleas have been taken without substantiating them. These issues are, therefore, decided against the defendants.

ISSUE NOS:

2. Whether the plaintiff is entitled to the suit amount and interest, if so, of what amount and rate?

.... OPP

10. Whether the plaintiff has unauthorizedly debited, the account of the defendants to several charges including expenses and interest. If so, its effect?

.....OPD

These issues being interconnected are taken up for decision together. There is again no evidence on record to prove that any unauthorized amount has been debited to the account of the defendants. In fact, it was the defendants' duty to have clarified and enumerated the so called unauthorized amount debited in their account and proved these allegations by clear and cogent evidence. There is no evidence on the record to substantiate these allegations by the defendants

I have already held on the other issues that the suit of the plaintiff is within limitation and that agreements executed between the parties have not been substituted till date. Ext. PW-2/M is a

promissory note for Rs. 17 lacs and Ext. PW-2/N is for Rs. 11.52 lacs executed by the defendants. Ext. PW-2/O is loan agreement executed on 26th May, 1992, Ext. PW-2/P is the other loan agreement executed on 19th October, 1992. Ext. PW-2/Q and Ext.PW-2/R are two agreements of hypothecation of the two loans sanctioned to the defendants. Ext.PW-2/S is the deed(s) of guarantee executed on 26th May, 1992 by defendant Nos. 2, 3 and 4. Similarly Ext. PW-2/T is the deed(s) of guarantee executed on the same date by defendant No. 5. These agreements guarantee the repayment of the first loan of Rs. 17 lacs. To similar effect are two more deed(s) of guarantee executed by the defendants Ext. PW-2/U on the 19th October, 1992, guaranteeing the repayment of loan of Rs. 11.54 lacs. Learned counsel for the plaintiff submitted that he is entitled to the suit amount as claimed in the suit and that a sum of more than Rs. 73,27,868-00/- has been written off by the plaintiff.

The loan documents noticed herein before do not disclose a uniform rate of interest to be charged from the defendants. PW-2 Pawan Kumar Bali in his statement has affirmed that the defendants were liable to pay interest @ 20% on the first loan of Rs. 17 lacs and 19% on the second loan of Rs. 11.40 lacs. This interest, according to him was to be charged on half yearly compounding basis. In cross examination, he admits that according to the notification issued by the IDBI dated 4th May, 1992, prevalent rate of interest was 16% and that different rates of interest were provided by the notification of IDBI for different purposes. This deposition assumes importance as the loan documents stipulates different rates

of interest tied to the interest rate charged by the IDBI. The two promissory notes Ext. PW-2/M and Ext. PW-2/N for Rs. 17 lacs and 11.54 lacs provided that the rate of interest would be at the rate of 8% above the bank rate subject to the minimum of 24% per annum with half yearly rests and second 7% above the SIDBI rate subject to a minimum of 23% per annum with half yearly rests. The copy of the ledger account, Ext. PW-1/B stipulates rate of interest at the rate of 3% above the SIDBI rate with minimum rate of 16%. There are unauthenticated cuttings on this document. Ext. PW-1/A stipulates interest at the rate of 3% above the IDBI rate which has been fixed on 16% with effective rate of 19%. No rests have been provided for. Ext. PW-2/O loan agreement dated 26th May, 1992 stipulates that if the plaintiff obtains refinance from the IDBI, the rate of interest will be 4% above the IDBI refinance rate on the amount of term loan outstanding against which refinance has been obtained. To similar effect is the interest clause Ext. PW-2/P loan agreement dated 19th October, 1992. Hypothecation agreement Ext. PW-2/Q dated 26th May, 1992 stipulates that borrower shall pay interest on the loan of the balance at the rate of 8% above the bank rate with a minimum of 24% per annum. Ext. PW-2/R which is the hypothecation agreement for the second loan stipulates rate of interest at the rate of 7% above the bank rates with a minimum of 23% per annum. Reading of these documents would show that rate of interest has not been fixed. Various documents provided for different rates. There is no notification on the record to show as to what was the bank rate when loan was advanced and the subsequent

variations in such rates, if any, and the rate fixed by the IDBI. PW-1 Rajinder Prasad Jain, Senior Manager has admitted in his cross examination that there are cuttings in the original account books and that the reprint which has been produced on record does not show such cuttings alterations etc. The original ledger was summoned from the plaintiff and a scrutiny of the account of the defendant does show that the rate of interest has been altered. There is no authentication of this rate. It also needs to be noticed that none of these documents stipulates or provide for compounding interest as claimed by the plaintiff. In these circumstances, the task of determining the contractual rate of interest becomes very difficult. In **Central Bank of India** *vs*. **Ravindra and others (2002) 1 SCC 367**, the Hon'ble Supreme Court lays down that:-

> "36 The English decisions and the decisions of this Court and almost all the High Courts of the country have noticed and approved long established banking practice of charging interest at reasonable rates on periodical rests and capitalizing the same on remaining unpaid. Such a practice is prevalent and also recognized in non-banking money lending transactions. The Legislature has stepped in from time to time to relieve the debtors from hardship whenever it has found the practice of charging compound interest and its capitalization to be oppressive and hence needing to be curbed. The practice is permissible, legal and judicially upheld excepting when superseded by legislation. There is nothing wrong in the parties voluntarily entering into transactions, evidenced by deeds incorporating covenant or stipulation for payment of compound interest at reasonable rates, and authorizing the creditor to capitalize the interest on remaining unpaid so as to enable interest being charged at the agreed rate on the interest component of the capitalized sum for the succeeding period.

Interest once capitalized, sheds its colour of being interest and becomes a part of principal so as to bind the debtor/borrower."

The Court concluded:-

"49. We are, therefore, of the opinion that two-Judge Bench decision of this Court in *Corporation Bank v. D. S. Gowda* (1994) 5 SCC 213 and the three-Judge Bench decision in *Bank of Baroda v. Jagannath Pigment and Chemicals* (1996) 5 SCC 280 are correctly decided and are, therefore, affirmed. A creditor can charge interest from his debtor on periodical rests and also capitalize the same so as to make it a part of the principal. Such a course can be justified by stipulation in a contract voluntarily entered into between the parties or by a practice or usage well established in the world to which the parties belong. Such practice is to be found already in vogue in the field of banking business. Such contract or usage or practice can stand abrogated by legislation such as Usury Laws or Debt Relief Laws and so on."

At the same time words of caution were sounded by the Court:-

"55……..

(1) Though interest can be capitalized on the analogy that the interest falling due on the accrued date and remaining unpaid, partakes the character of amount advanced on that date, yet penal interest, which is charged by way of penalty for non-payment, cannot be capitalized. Further interest, i. e. interest on interest, whether simple, compound or penal, cannot be claimed on the amount of penal interest. Penal interest cannot be capitalized. It will be opposed to public policy.

(2) Novation, that is, a debtor entering into a fresh agreement with creditor undertaking payment of previously borrowed

principal amount coupled with interest by treating the sum total as principal, any contract express or implied and an express acknowledgment of accounts are best evidence of capitalization. Acquiescence in the method of accounting adopted by the creditor and brought to the knowledge of the debtor may also enable interest being converted into principal. A mere failure to protest is not acquiescence.

(3) The prevalence of banking practice legitimatises stipulations as to interest on periodical rests and their capitalization being incorporated in contracts. Such stipulations incorporated in contracts voluntarily entered into and binding on the parties shall govern the substantive rights and obligations of the parties as to recovery and payment of interest.

(4). Capitalization method is founded on the principle that the borrower failed to make payment though he could have made and thereby rendered himself a defaulter. To hold an amount debited to the account of the borrower capitalized it should appear that the borrower had an opportunity of making the payment on the date of entry or within a reasonable time or period of grace from the date of debit entry or the amount falling due and thereby avoiding capitalization. Any debit entry in the account of the borrower and claimed to have been capitalized so as to form an amalgam of the principal sum may be excluded on being shown to the satisfaction of the Court that such debit entry was not brought to the notice of the borrower and/or he did not have the opportunity of making payment before capitalization and thereby excluding its capitalization.

(5) The power conferred by Sections 21 and 35-A of the Banking Regulation Act, 1949 is coupled with duty to act. Reserve Bank of India is prime banking institution of the

country entrusted with a supervisory role over banking and conferred with the authority of issuing binding directions, having statutory force, in the interest of public in general and preventing banking affairs from deterioration and prejudice as also to secure the proper management of any banking company generally. The Reserve Bank of India is one of the watchdogs of finance and economy of the nation. It is, and it ought to be, aware of all relevant factors, including credit conditions as prevailing, which would invite its policy decisions. RBI has been issuing directions/circulars from time to time which, inter alia, deal with rate of interest which can be charged and the periods at the end of which rests can be struck down, interest calculated thereon and charged and capitalized. It should continue to issue such directives. Its circulars shall bind those who fall within the net of such directives. For such transaction which are not squarely governed by such circulars, the RBI directives may be treated as standards for the purpose of deciding whether the interest charged is excessive, usurious or opposed to public policy.

(6) Agricultural borrowing are to be treated on a pedestal different from others. Charging and capitalization of interest on agricultural loans cannot be permitted in India except on annual or six monthly rests depending on the rotation of crops in the area to which the agriculturist borrowers belong.

(7) Any interest charged and/or capitalized in violation of RBI directives, as to rate of interest, or as to periods at which rests can be arrived at, shall be disallowed and/or excluded from capital sum and be treated only as interest and dealt with accordingly.

(8) Award of interest *pendente lite* and post-decree is discretionary with the Court as it is essentially governed by Section 34 of the CPC *dehors* the contract between the

parties. In a given case if the Court finds that in the principal sum adjudged on the date of the suit the component of interest is disproportionate with the component of the principal sum actually advanced the Court may exercise its discretion in awarding interest *pendente lite* and post-decree interest at a lower rate or may even decline awarding such interest. The discretion shall be exercised fairly, judiciously and for reasons and not in an arbitrary or fanciful manner."

Section 34 of the Code of Civil Procedure stipulates that in case of commercial transactions, the stipulated rate agreed to between the parties is to be granted. The documents placed on record do not provide for capitalization of the interest i.e. charging of interest on compounding basis. The plaintiff has not placed on record any notification issued by the Reserve Bank of India, Ministry of Finance, IDBI or SIDBI. The ledger account also contains unauthenticated cuttings which does raise serious doubts in my mind as to the stipulated rate and the method on which it is to be charged. I am conscious to the fact that the loan is one for commercial purposes. Taking the entirety of the evidence on the record, the suit of the plaintiff is decreed in the sum of Rs. 28.54 lacs along with interest to be charged on simple interest basis @ 12% per annum from the date of suit till its recovery. Let a decree in these terms be drawn up. There shall be no order as to costs.

1st January, 2008. **(Dev Darshan Sud),**
(cm) **Judge.**